UNITED STATES OF AMERICA Before the COMMODITY FUTURES TRADING COMMISSION

DELBERT DUNMIRE

V.

MATTHEW STEPHEN HOFFMAN, ROBERT BRUCE LEE, MORGAN STANLEY DW, INC. and LAWRENCE J. SCHNEIDER CFTC Docket No. 04 ROS1 # 28

ORDER GRANTING

This case is before the Commission on complainant Delbert Dunmire's ("Dunmire") a for interlocutory review of an order by the Administrative Law Judge ("ALJ") retaining

INTERLOCUTORY REVIEW

petition for interlocutory review of an order by the Administrative Law Judge ("ALJ") retaining jurisdiction over a counterclaim after dismissing the complaint for lack of jurisdiction. For the reasons that follow, we grant the petition and dismiss the counterclaim, without prejudice.

In May 2004, complainant Delbert Dunmire ("Dunmire") filed a reparations complaint seeking over \$2 million in damages from futures commission merchant Morgan Stanley DW, Inc. ("Morgan Stanley"), and three of its employees. Dunmire denominated his claims as "breach of contract," "breach of fiduciary duty," and "negligence," and set forth factual allegations describing how he had been harmed. Complaint at 4, 6, 7. In response, Morgan Stanley argued that Dunmire was not properly in the reparations forum because he had not alleged cognizable violations under the Commodity Exchange Act ("Act") or Commission rules. Ans. at 13 and n.5. Morgan Stanley also filed a counterclaim for a \$1.4 million debit balance in Dunmire's account.

On May 10, 2005, six weeks before this case was to be heard before the ALJ, Dunmire moved for dismissal of his complaint on the ground that he and Morgan Stanley were engaged in litigation in two other forums. Dunmire stated that he had filed a claim in the National Futures Association's ("NFA") arbitration forum. Dunmire also stated that he and Morgan Stanley were engaged in separate litigation in the United States District Court for the Western District of Missouri. He argued that Commission Rule 12.24, which bars the Commission from hearing reparations claims between parties engaged in "parallel proceedings," required dismissal of his complaint without prejudice. Motion to Dismiss at 1.

Dunmire stated further that when he filed his complaint, he believed that Morgan Stanley's wrongful conduct violated the Act and Commission regulations. *Id.* at 2. He asserted that in "the course of reviewing" discovery materials, he had come to conclude that the "large majority of [the] wrongful conduct arises from a breach of . . . common law duties" over which the CFTC has no jurisdiction rather than from violations of the Act or Commission regulations.

An arbitration proceeding or civil court proceeding, involving one or more of the respondents as a party, which is pending at the time the reparation complaint is filed and involves claims or counterclaims that are based on the same set of facts which serve as a basis for all of the claims in the reparations complaint, and which either:

- (i) Was commenced at the instance of the complainant in reparations; or
- (ii) Involves counterclaims by the complainant in reparations alleging violations of the Commodity Exchange Act, or any regulation or order issued thereunder; or
- (iii) Is governed by a compulsory counterclaim rule of federal court procedure which required the complainant in reparations to assert all of his claims (including those based on alleged violations of the Commodity Exchange Act, and any regulation or order issued thereunder) as counterclaims in that proceeding[.]

¹ With his motion of interlocutory review, Dunmire submitted a copy of the arbitration application dated May 4, 2005.

² Dunmire v. Morgan Stanley DW, Inc., Docket No. 04-1059 (filed Nov. 11, 2004).

³ As pertinent to this proceeding, Commission Rule 12.24(a)(1) defines a "parallel proceeding" as:

Id. at 2-3. He acknowledged that he might be unable to show that some of respondents' alleged injurious actions rose "to the level of willful and wanton" conduct, but might be "simple negligence." Id. at 3. Dunmire argued that because the Commission lacks jurisdiction to resolve all of the claims in this case, his complaint should be dismissed to allow the parties to proceed in another forum with jurisdiction to hear all of their disputes.

Respondents opposed dismissal under Rule 12.24, asserting that it did not apply because the NFA arbitration and the federal case were not parallel proceedings within the meaning of this rule. They accused Dunmire of forum shopping, and argued that if he were permitted to "walk away from this case," it should be with prejudice. Res. Opposition to Motion to Dismiss at 1. They contended that Dunmire "never has stated a viable reparations claim to begin with." *Id.* Respondents urged the ALJ to dismiss Dunmire's complaint under Commission Rule 12.308(c)(2), which provides for dismissal of individual claims, or entire proceedings, as to which the Commission is found to lack jurisdiction. *Id.* at 2, 5. At the same time, respondents argued that the ALJ retained jurisdiction over their counterclaim.

⁴ Commission Rule 12.308(c) provides for dismissal as follows:

⁽¹⁾ By the Administrative Law Judge. The Administrative Law Judge, acting on his own motion, may, at any time after he has been assigned the case:

⁽i) Dismiss the entire proceeding, without prejudice to counterclaims, if he finds that none of the matters alleged in the complaint state a claim that is cognizable in reparations; or

⁽ii) Order dismissal of any claim, counterclaim, or party from the proceeding if he finds that such claim or counterclaim (by itself, or as applied to a party) is not cognizable in reparations.

⁽²⁾ Motion for dismissal by a party. Any party who believes that grounds exist for dismissal of the entire complaint, of any claim therein, of any counterclaim, or of a party from the proceeding, may file a motion for dismissal specifying the claims, counterclaims, or parties to be dismissed and the reasons therefor. Upon consideration of the whole record, the Administrative Law Judge may grant or deny such motion, in whole or in part.

⁽³⁾ Content and effect of order of dismissal. Any order of dismissal entered pursuant to this rule shall contain a brief statement of the findings and conclusions which serve as the basis for the order. An order of dismissal of the entire proceeding pursuant to this rule shall have the effect of an initial decision which may be appealed to the Commission in accordance with the requirements set forth in

By an order dated May 20, 2005, the ALJ found that Dunmire failed to state a "cognizable reparations claim" and dismissed his complaint. May 20, 2005 Order at 2. He retained jurisdiction over Morgan Stanley's counterclaim for the debit balance in Dunmire's account and set a hearing date. On May 26, 2005, the ALJ issued a second order clarifying the scope of the hearing. He announced that he would hear only "evidence concerning the debit balance," and would not hear or consider evidence regarding the dismissed reparations complaint or evidence concerning the deficit in Dunmire's asset account. *Id.* He stated, "[t]he sole purpose of the hearing will be to determine the extent of any damages sustained by Morgan Stanley by reason of Complainant's failure to meet margin calls." *Id.*

Dunmire asked the ALJ to certify for interlocutory review the question of the ALJ's jurisdiction to hear the counterclaim, and also asked him to stay the hearing pending review. The ALJ denied both requests. *See* Order of June 1, 2005 (refusing to certify) and Order of June 7, 2005 (refusing to stay). Dunmire then sought interlocutory review with the Commission, without certification. Specifically, Dunmire sought dismissal of the "entire proceeding for lack of subject matter jurisdiction so that all claims [could] be presented at one time in the parallel proceeding currently pending" at the NFA. Petition for Interlocutory Review at 1. On June 16, 2005, by delegated authority, the Commission found that the ALJ's ruling retaining jurisdiction over the counterclaim satisfied the conditions of Commission Rule 12.309(a)(4).⁵ Accordingly, it took review of the issue and stayed the proceeding.

^{§ 12.401} of these rules.

⁵ Commission Rule 12.309(a)(4) provides that interlocutory review is available at the Commission's discretion, despite the absence of certification, when the conditions of Commission Rule 12.309(a)(3) are met and extraordinary circumstances are shown to exist. Those conditions are:

⁽i) a ruling sought to be appealed involves a controlling question of law or policy;

⁽ii) an immediate appeal may materially advance the ultimate resolution of the issues in the proceeding; and

Dunmire's reliance on the parallel proceedings rule is unavailing. Rule 12.24(a)(1) defines a parallel proceeding as "[a]n arbitration or civil court proceeding . . . which is pending at the time the reparation complaint is filed" (emphasis added). The rule, on its face, does not apply to proceedings initiated afterwards. See Tager v. Conti Commodity Services, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,906 (CFTC Sept. 18, 1987) (applying the rule). Both of the proceedings identified by Dunmire were initiated after the reparations complaint was filed; the federal case six months, the NFA arbitration 12 months.

Although the ALJ cited no authority in dismissing the complaint, it appears that he relied upon Commission Rule 12.308(c), governing dismissal of non-cognizable claims. Under that rule, when an ALJ finds that none of the matters alleged in the complaint states a claim that is cognizable in reparations, the entire proceeding is to be dismissed. When Rule 12.308 was promulgated in 1984, the Commission specifically rejected any notion that a counterclaim survives dismissal of a reparations complaint. See Final Rules Relating to Reparations, 49 Fed. Reg. 6602 (CFTC Feb. 22, 1984) ("Final Rules"). The Commission stated:

Commenters recommended that even if the Commission finds a complaint to be defective, and therefore, not the proper subject of a proceeding, or subject to dismissal, after a proceeding has been instituted, the Commission should permit a proceeding to go forward as to counterclaims Congress' overriding purpose in creating reparations was to provide a forum for aggrieved customers seeking redress for losses sustained as a result of violations of the Act committed by commodity professionals registered under the act. If a commodity customer's claims are not forwarded for a proceeding, or are dismissed without prejudice, because they are not cognizable in reparations, the Commission does not believe that Congress intended the Commission to devote its scarce resources to adjudicating only claims by registrants against customers. Accordingly, . . . [Rule] 12.308 of the newly adopted rules only authorize[s]

⁽iii) subsequent reversal of the ruling would cause unnecessary delay or expense to the parties.

either the termination of consideration of all of the pleadings or the dismissal of the entire proceeding, if none of the claims in the complaint are cognizable in reparations.

Id. at 6609 n.18 (citation omitted).

Both the ALJ and the respondents rely on *CFTC v. Schor*, 478 U.S. 833 (1986) for the proposition that the counterclaim survives dismissal of Dunmire's complaint. Their reliance is misplaced. The issue before the Court in *Schor* was whether, in passing the Act, Congress empowered the CFTC to adopt Commission Rule 12.23(b)(2), allowing it to adjudicate state law counterclaims "aris[ing] out of the transaction or occurrence or series of transactions or occurrences set forth in the complaint," and if so, whether the grant of that authority comported with Article III of the Constitution giving jurisdiction over such claims to Article III courts. *Id.* at 837 (quoting Commission Rule 12.23(b)(2), 17 C.F.R. § 12.23(b)(2) (1983) (alteration in the original). Answering both parts of the question in the affirmative, the Court stated, *inter alia*:

Our examination of the [Act] and its legislative history and purpose reveals that Congress plainly intended the CFTC to decide counterclaims asserted by respondents in reparations proceedings, and just as plainly delegated to the CFTC the authority to fashion its counterclaim jurisdiction in the manner the CFTC determined necessary to further the purposes of the reparations program.

Id. at 843; see also id. at 842 ("[C]onsistent with the sweeping authority Congress delegated to the CFTC generally" to administer the Act, "Congress intended to vest in the CFTC the power to define the scope of the counterclaims cognizable in reparations proceedings[.]")⁷ As discussed

⁶ This rule has been redesignated as Commission Rule 12.19(b), 17 C.F.R. § 12.19(b) (1984), but its substance remains the same.

In finding that the Commission has clear authority to exercise jurisdiction over common law counterclaims arising out of the same transaction or occurrence as a reparations claim, the Court did not decide whether the agency may entertain such a counterclaim if the predicate reparations claim is dismissed for lack of jurisdiction. With respect to whether the Commission's counterclaim rule was constitutional, however, the Court emphasized the limited nature of the CFTC's assertion of counterclaim jurisdiction and observed that it was confined "to that which is necessary to make the reparations procedure workable[,]" and "incidental to, and completely dependent upon, adjudication of reparations claims created by federal law[.]" *Id.* at 856.

above, in promulgating Commission Rule 12.308(c), the CFTC determined that when a claimant's claims are not forwarded for a proceeding or are dismissed without prejudice because none of the claims are cognizable in reparations, the entire proceeding—including any counterclaims—must be dismissed.

Respondents cite *Friedman v. Dean Witter & Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,307 (CFTC Nov. 13, 1981), and *Hussein v. Saul Stone & Co., LLC*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,460 (CFTC Apr. 22, 2003), for the proposition that the Commission has exercised jurisdiction over counterclaims in the past despite having dismissed the predicate reparations claim. Respondents' Opposition to Claimant's Motion to Dismiss at 7-8. In those cases, however, the reparations claims were dismissed, not without prejudice for lack of jurisdiction, but on the merits after a hearing. We note, moreover, that *Friedman* was decided before the promulgation of Rule 12.308 in 1984.

Morgan Stanley contends that even though the ALJ found that Dunmire failed to state a cognizable reparations claim, Dunmire's allegations were sufficient to vest the Commission with original jurisdiction over it and thus, also, the counterclaim. Respondents' Opposition to Complainant's Petition for Interlocutory Review at 7. Morgan Stanley argues that supplemental jurisdiction over the counterclaim is not necessarily divested when it becomes apparent through subsequent development of the case that original jurisdiction over the main claim cannot be established. *Id.* at 7-8. Respondents point to 28 U.S.C. §1367 (governing supplemental

make the reparations procedure workable[,]" and "incidental to, and completely dependent upon, adjudication of reparations claims created by federal law[.]" *Id.* at 856.

⁸ As in the present case, in both of these cases the claimant alleged that his broker violated the Act by liquidating the account after it had become undermargined, which resulted in a debit balance owed by the claimant to the broker that became the subject of the counterclaim.

⁹ Although in *Friedman*, the Commission ultimately concluded that "complainant ha[d] not established a cognizable cause of action against respondent," *Friedman*, ¶ 21,307 at 25,538, the complainant alleged and attempted—but failed—to prove a violation of Section 4b of the Act. *See id.*, at 25,535, 25,537 n. 8.

jurisdiction by federal district courts, and which provides such courts with discretion to continue to exercise jurisdiction over state law claims after dismissal of all claims over which it had original jurisdiction), as illustrative of this general principle. *Id.* Whether the Commission has similar authority to exercise such supplemental jurisdiction, however, is beside the point. In promulgating Rule 12.308(c), the Commission determined that, when faced with such a situation, it would not do so.

To the extent that Respondents may be urging us to construe the ALJ's rejection of Dunmire's complaint as a dismissal on the merits, in which case retention of jurisdiction over the counterclaim would have been appropriate, we decline to do so. Had the ALJ desired to dismiss the complaint on the merits, he had an available avenue under Commission Rule 12.310(d), providing for summary disposition by an ALJ on his own motion. If the ALJ had believed that one of the parties might have been entitled to a decision as a matter of law, then, as contemplated by Rule 12.310(d), he could have directed the parties to submit arguments in support of and in opposition to summary disposition, and if necessary, entertained oral argument. He did not do so, and elected instead to dismiss the complaint based upon Dunmire's failure to state a cognizable claim, invoking the language of Rule 12.308.

Developments in this case reflect our approach to pleading. Dunmire's claim was not rendered fatally defective because he labeled his claims as breach of contract, inasmuch as he alleged conduct colorably within the ambit of our reparations jurisdiction. See, e.g., Judd v. The Churchill Group, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. ¶ 25,589 (CFTC Sept. 30, 1992) (finding that fair notice of the theory of liability is all that is required). See also Final Rules, 49 Fed. Reg. at 6607 (requiring reparations claimants to provide an "intelligible notice" of the complained-of conduct, and rejecting commenters' suggestions that claimants be required to

cite specific provisions of the Act or Commission rules alleged to have been violated, or to plead fraud with particularity). *Cf. Doe v. Smith*, 429 F.3d 706 (7th Cir. 2005) (plaintiffs do not plead facts or law; they plead claims for relief—the defendant needs only to know what he has been accused of).

To recover in reparations, however, a complainant must establish *scienter*; injurious action by the wrongdoer is not enough. *Hammond v. Smith Barney, Harris Upham & Co., Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 (CFTC Mar. 1, 1990). The Commission has no authority to award reparations to a wronged party unless the wrongdoer intended the offending act, or was reckless in allowing it to happen. The forum does not reach negligent conduct or breaches of contract where intent or recklessness may not be present and need not be shown. *See Tysdal v. Jack Carl/312 Futures, Inc.* [1990-1992 Transfer Binder] (CCH) Comm. Fut. L. Rep. ¶ 25,242, 38,712 n.5 (CFTC Feb. 27, 1992) (dismissing a breach of contract claim because the mere breach of an agreement, absent some showing of fraudulent intent on the part of the breaching party, does not constitute a violation of Section 4b; and dismissing negligence claims because negligence is insufficient to satisfy Section 4b's *scienter* requirement).

After a year of prehearing proceedings, Dunmire became convinced that even if he were able to prove that the injurious conduct actually happened as alleged, he was not sure that he would be able to establish that respondents acted with *scienter*. Rather than proceed to a hearing, Dunmire sought to terminate his case before the Commission. Once the ALJ decided to dismiss it on jurisdictional grounds, he lost jurisdiction over Morgan Stanley's counterclaim.

Accordingly, the relief sought in the petition for interlocutory review is granted, and the counterclaim is dismissed without prejudice.

IT IS SO ORDERED.10

By the Commission (Chairman JEFFERY and Commissioners LUKKEN, BROWN-HRUSKA, HATFIELD, and DUNN).

Jean A. Webb

Secretary of the Commission

Commodity Futures Trading Commission

Dated: March 2, 2006

¹⁰ Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e) (2000)), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing was held, the appeal may be filed in any circuit in which the appellee is located. The statute also states that such an appeal must be filed within 15 days after notice of the order, and that any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.